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FEDERAL COMMUNICATIONS COMMISSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Universal Service Federal-State	)	CC Docket No. 96-45
Joint Board's Second Recommended	)	DA 98-2410
Decision	)	

COMMENTS OF GTE

Dated: December 23, 1998

GTE Service Corporation and its designated affiliated companies

John F. Raposa
GTE Service Corporation
600 Hidden Ridge, HQE03J27
P.O. Box 152092
Irving, TX 75015-2092
(972) 718-6969

Gail L. Polivy
GTE Service Corporation
1850 M Street, N.W., Suite 1200
Washington, DC 20036
(202) 463-5214

Their Attorneys

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TABLE OF CONTENTS

SUMMARY

The Recommended Decision represents a small step forward in the Commission's attempt to comply with the requisites of Section 254 of the 1996 Act. Unfortunately, the Joint Board's recommendations are very broad. Much is therefore left to the initiative of the Commission in shaping the specifics of the federal universal service plan, and states are left with the primary burden of funding universal service.

The Joint Board recognizes that affordable local service is made possible today by a web of implicit subsidies from other services. The Joint Board envisions a framework in which each regulator – the Commission and each state commission – is responsible for replacing the implicit universal service support generated today by rates within its jurisdiction. GTE urges the Commission to step up to the challenge presented to it by the Joint Board: to replace the universal service support provided today by interstate access charges, and to provide the resources that states need to maintain comparable rates.

Today, interstate access charges provide an annual flow of support for universal service of about $5.9 billion dollars. The Joint Board recognizes that the Commission has the responsibility for dealing with this subsidy. The new federal universal service mechanism that the Commission implements in July, 1999 must replace this hidden subsidy with explicit, competitively neutral funding.

Replacing the implicit subsidy in interstate access will produce immediate and tangible benefits:

- It will make universal service support secure, as Congress intended.

- It will allow massive reductions in interstate access charges, which will benefit consumers. By removing price distortions, it will allow customers and providers alike to make better, more efficient choices.
- It will open up the local market to competition. Today, new firms are not rushing to offer local service, especially to residence customers. Why should anyone want to compete against a price that is subsidized? By making the current subsidy explicit, the Commission can make it available on a portable basis to competitors. Residence customers will benefit, because carriers will want to compete for their business.

All of these benefits can be obtained without harming any group of residence local subscribers. A recent study by USTA shows that, if the current interstate access subsidy is replaced with explicit funding, residence customers will, on average, see their monthly bills go <u>down</u>. Customers benefit at every income level, and every usage level – even those customers who do not make any long distance calls.

The current implicit subsidy mechanism is inefficient and unfair, and it is holding back the development of competition. Rather than maintain some sort of death watch over the current system, the Commission should act now to replace it with a more efficient, fair, and competitively neutral explicit funding mechanism.

The Joint Board also recognizes that, while states have the primary responsibility for dealing with subsidy issues within their borders, some states lack the resources to replace the current implicit subsidies from intrastate rates, while maintaining affordable local rates at levels comparable to those in other states. The Joint Board proposes that the federal universal service mechanism should provide additional funding to those states. GTE supports this objective.

It is not possible for GTE, or any other party, to evaluate the alternative methods for calculating support suggested by the Joint Board without knowing how the Commission will estimate universal service costs. The Commission should complete work on its cost model, including the necessary inputs. It should then give parties an opportunity to comment on the calculation of universal service support to be provided by the federal plan to the states. The Commission should also develop external targets for the necessary amount of support, so that the size of the fund is not dependent on the vagaries of the cost modeling process. GTE also supports the Joint Board's proposal that no state should receive less support from federal mechanisms than it receives today; the new plan should not leave any state with a greater universal service problem than it already has.

GTE agrees with the Joint Board that contributions to the fund should be based on each carrier's total retail revenue, both state and interstate. Each carrier should be able to recover its contribution from its customers through a separate item on the bill. This is an important issue of competitive neutrality for incumbent local exchange carriers (ILECs), because they do not have the flexibility other carriers have to adjust their service rates. It is reasonable to limit the charge, as the Joint Board suggests, to an amount that reflects the rate at which the carrier must contribute to the fund.

GTE also agrees with the Joint Board that the Commission may condition the receipt of funds to ensure that carriers further the purposes of Section 254. GTE proposes that any carrier that receives support should be required to provide service to any customer in its service area at a rate found to be affordable by the state commission.

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COMMENTS OF GTE

On July 17, 1998 the Commission referred a series of issues to the Federal-State Joint Board on Universal Service.[1] In response to this referral, on November 25, 1998, the Joint Board released a Second Recommended Decision.[2] GTE Service Corporation and its designated affiliates[3] (collectively,

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1 Federal-State Board on Universal Service, Order and Order on Reconsideration, CC Docket No. 96-45, FCC 98-160 (released July 17, 1998) ("Referral Order").

2 Federal-State Joint Board on Universal Service, Second Recommended Decision, CC Docket No. 96-45, FCC 98J-7 (released November 25, 1998) ("Second Recommended Decision").

3 These Comments are filed on behalf of GTE's affiliated domestic telephone operating companies, GTE Wireless Incorporated, and GTE Communications Corporation. GTE's domestic telephone operating companies are: GTE Alaska Incorporated, GTE Arkansas Incorporated, GTE California Incorporated, GTE Florida Incorporated, GTE Hawaiian Telephone Company Incorporated, The Micronesian Telecommunications Corporation, GTE Midwest Incorporated, GTE North Incorporated, GTE Northwest Incorporated, GTE South Incorporated, GTE Southwest Incorporated, Contel of Minnesota, Inc., and Contel of the South, Inc.

"GTE") herewith submit their Comments on that Second Recommended Decision.[4]

I. INTRODUCTION

The Second Recommended Decision represents a small step forward in the Commission's attempt to comply with the requisites of Section 254 of the 1996 Act.[5] Unfortunately, however, the Joint Board's recommendations are presented in only the most general terms. Much is left to the Commission's initiative in determining the specifics of the federal plan, and much is left to the states in providing the explicit funding needed to maintain universal service at affordable rates. If, and only if, all of these regulatory agencies fulfill their respective roles, then the framework presented in the Second Recommended Decision would be a step forward in the right direction. In these Comments, GTE

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4 These comments are submitted without prejudice to the pending judicial review of the Commission's *Universal Service Order*, 12 FCC Rcd 8776 (1997). *Texas Office of Public Utility Counsel v. FCC*, No. 97-60421 (5th Cir.). Specifically, the use of a model to determine the forward-looking costs of a nonexistent, hypothetical network – in contrast to the actual costs of the real network – for the purposes of establishing universal service support is inconsistent with Section 254 of the Act. Indeed, even if such cost modeling were legally permissible – which it is not – the recently-released *Platform Order*, FCC 98-279 (released October 28, 1998) is replete with deficiencies, not the least of which is the Commission's failure and refusal to make available critical information regarding the so-called synthesized model. *See, e.g.*, Petition of GTE for Reconsideration of the Commission's Fifth Report and Order, filed December 18, 1998.

5 The Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (February 8, 1998), *codified at* 47 U.S.C. § 153 *et seq.* (the "1996 Act"). All reference to the "Act" are to the Communications Act of 1934, as amended by the 1996 Act.

focuses on the actions that the Commission must take in the next few months to address its part of this challenge, and then offers concrete suggestions with respect to the generalities of the Second Recommended Decision.

II. THE PURPOSES OF SUPPORT

As the Second Recommended Decision notes, basic local service is widely available today at rates that are affordable.[6] This is made possible by a web of existing support mechanisms. Most of the existing support is implicit; incumbent local exchange carriers ("ILECs") charge relatively high rates for some services, such as access, toll, vertical services, and business services, so that they may charge relatively low prices for basic local service. A small portion of the existing support comes from the current explicit mechanisms, such as the federal high cost fund. The Second Recommended Decision analyzes the need for universal service funding by reviewing the current support flows, and asking how those mechanisms must be changed or replaced in order to arrive at a new system that is satisfactory. GTE believes that this approach is reasonable, as long as the need for fundamental reform of the current system is faced squarely.

A. The Commission Should Make Interstate Support Explicit.

Today, a significant proportion of the support for universal service is implicit support generated by interstate access rates. GTE estimates that the current level of this implicit support flow is about $5.9 billion annually. The Joint Board recognizes that the Commission has the authority to replace this implicit

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6 Second Recommended Decision at ¶ 3.

support flow with explicit funding.[7] GTE agrees, and urges the Commission take this vital step as part of its new federal universal service plan to be implemented in July, 1999. In essence, the Joint Board recommends that the Commission and each of the states should take responsibility for the implicit support generated by rates for services within their respective jurisdictions. The federal universal service plan is the only mechanism through which interstate implicit support can be made explicit, and it is the Commission's responsibility to ensure that the federal plan, whatever other tasks it may undertake, is at least sufficient to accomplish this goal.

USTA has submitted a proposal that would address the portion of the current implicit interstate support flow that is provided today by common line rates – about $4.3 billion annually. GTE strongly supports the USTA proposal, but urges the Commission as well to adopt a mechanism that would replace the implicit support flow from traffic sensitive access rates, which represents the difference between the USTA estimate and GTE's support estimate of $5.9 billion.

1. Replacing implicit support is necessary to promote competition, to preserve universal service, and to meet the requirements of the Act.

As the Second Recommended Decision notes, the Commission has already concluded that removing implicit support from interstate rates should be its policy goal. The Commission has also concluded that universal service

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7 *Id.* at ¶ 23.

support implicit in rates cannot be sustained as competition develops.[8] GTE agrees that making the current implicit support flow from interstate access explicit is the only way to ensure that this support will be preserved, and that it will remain predictable.

In her separate statement, Commissioner Ness appears to suggest that the Commission could take an incremental, wait-and-see approach to replacing implicit support, providing "whatever explicit support is needed as competition diminishes the availability of implicit support."[9] GTE submits that such an approach is neither feasible, nor desirable, nor consistent with the requirements of the Act.

A wait-and-see approach is infeasible because the Commission will not be able to measure and respond to incremental changes in the "availability of implicit support" in a timely manner as competition develops. It is undesirable because it is based on the incorrect premise that implicit support should be maintained as long as possible – as if implicit support were somehow preferable, as a policy instrument, to a competitively neutral explicit mechanism. In fact, the opposite is true.

The current system of implicit support is inefficient and unfair. It burdens some customers with disproportionate contributions to universal service, while others contribute nothing. It distorts the price of access services, which distorts

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8 *Id.* at ¶ 21.

9 Separate Statement of Commissioner Susan Ness, at 1; *see also* Second Recommended Decision at ¶ 50.

customers' choices among alternative access services, provides artificial incentives for entry into access markets, and represses demand for interstate long distance services.[10] Perhaps most importantly, as long as affordable local service rates depend on implicit support, efficient competitive entry into local service markets will be preempted. Implicit support cannot be made portable to other carriers, and thus can never be competitively neutral. No rational competitor will choose to compete against a subsidized service if it cannot gain access to the subsidy.[11] Replacing the current implicit support will spread the burden of universal service more equitably, will provide better, more efficient price signals to the interstate access markets, and will promote efficient competition for local service by making the support for that service portable. These are important benefits that should not be delayed while some kind of

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10 The Second Recommended Decision notes (at ¶ 21) the Commission's finding that "unless implicit support is identified and eventually stripped from interstate access charges, those access charges could remain artificially high." The Second Recommended Decision also proposes (at & 23) that the new, explicit funding that is provided to replace interstate implicit support should be used to fund offsetting reductions in interstate access rates on a dollar-for-dollar basis. GTE agrees.

11 Western Wireless has emphasized the difficulty new firms face in entering local markets where they must compete with subsidized rates. Allowing implicit subsidies to remain is "a major impediment to the development of vigorous local competition, especially in rural and high-cost areas." Comments of Western Wireless Corporation, CC Docket No. 96-262, October 26, 1998, at 4. *See also* Prepared Remarks of John Stanton, Chairman and CEO of Western Wireless Corporation, Joint Board En Banc Hearing on Consumer Issues and Education, October 29, 1998: "[r]egulators must ensure that universal service support is fully portable – that is, that competitive providers receive the same dollar amount of support as incumbents for each line they serve."

death watch is observed over the demise of implicit support from access. The Commission should secure these benefits by taking action at the outset of its new universal service plan to replace all of the implicit support in interstate access.

Finally, continued reliance on implicit support is inconsistent with the Act. Section 254(b)(6) establishes the principle that all providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and enhancement of universal service. Section 254(d) requires that every carrier that provides interstate service shall contribute on an equitable and nondiscriminatory basis to federal support mechanisms. The current implicit support system, in which contributions are buried in the access rates of certain carriers – the ILECs – does not meet this statutory requirement. Carriers will be able to contribute to universal service support on an equitable basis only if that support is made explicit.

For all of these reasons, the Commission should not take a "wait-and see" approach to the replacement of implicit support from interstate access, but instead should take action to address this issue fully when its new universal service plan is implemented in July, 1999.

2. Interstate cost recovery will affect the affordability of basic local service.

The Second Recommended Decision suggests that the Commission's efforts to remove implicit universal service support from interstate access rates "will not affect intrastate rates directly."[12] In fact, the states have a considerable stake in the establishment of explicit support to replace the current implicit support from interstate access.

If the presence of implicit support contributes to the competitive erosion of ILEC interstate access demand, state rates can be affected as a result. A reduction in interstate access minutes would shift traffic-sensitive costs to the intrastate jurisdiction through the separations process. Further, to the extent that demand is lost to carriers using unbundled network elements ("UNEs"), the associated costs would most likely be shifted to the jurisdiction of the state.[13]

More broadly, the method chosen by the Commission to effect the recovery of interstate costs could have a dramatic effect on the affordability of local service. In its original access charge plan, the Commission determined that the most efficient method for the recovery of interstate common line costs is through subscriber line charges ("SLCs") assessed to end users. In response to concerns raised by the states and other parties that full recovery through SLCs would make local service unaffordable, the Commission agreed to cap the SLC

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12 Second Recommended Decision, at ¶ 22.

13 A Joint Board is now considering the jurisdictional allocation of UNE costs, and no change to the current separations rules has yet been recommended. However, a UNE is not a service, but the lease of a facility. Under current separations rules, the costs of rented or leased facilities are assigned to the jurisdiction in which the rental or lease revenue is generated. If the Supreme Court sustains the determination that states have jurisdiction over the setting of UNE rates, it certainly is reasonable to suppose that the associated UNE costs would also be assigned to the states.

at $3.50 per month for residence and single-line business customers.[14] Cost recovery that is permitted within the common line basket, but that cannot be accomplished through the capped SLCs, is made through the PICC and CCL charges. In effect, then, the PICC and the CCL are the federal universal service mechanisms that the Commission uses to keep SLC charges at affordable levels.

If there were no affordability concerns associated with the recovery of interstate common line costs, the Commission would be free to return to the pricing mechanism for the recovery of those costs that it has previously found to be the most efficient: full, cost-based SLCs.[15] Even on an averaged basis, this would allow residential SLCs to double from their current levels. If the Commission were also to deaverage these charges, to reflect the significant cost differences across small geographic areas indicated by all of the available cost models, the deaveraged, cost-based SLC in a high cost area could be very high indeed. If such SLCs were to be implemented, they would raise legitimate concerns about the affordability of basic local service, based on the sum of the local rate approved by the state and the interstate SLC charge.

In order to keep interstate SLC charges affordable, the Commission has capped those charges. The CCL and PICC may be thought of as the mechanism that allows each ILEC to recover the difference between the capped, affordable

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14 Higher caps apply to non-primary lines, and to multiline business.

15 The Second Recommended Decision notes (at ¶ 21) that implicit support from interstate access could be replaced either by explicit support or by "improved revenue recovery mechanisms."

SLC charge and the deaveraged, cost-based SLC that would otherwise reflect the interstate portion of each customer's loop cost. Since the Commission has already found that SLCs are the most efficient recovery mechanism, the only reason to cap SLCs would be to maintain universal service at affordable rates. Today, these caps are funded by the CCL and PICC charges.[16] These implicit funding mechanisms cannot be maintained in the future, for all the reasons previously set forth. If the Commission wishes to ensure that SLC charges will remain affordable in the future, then it must adopt an explicit, competitively neutral mechanism to fund the caps it places on SLC charges.

3. Subscribers will benefit from a more efficient explicit funding mechanism.

The Commission should not seek to maintain the current implicit flow of support from interstate access rates out of a misplaced desire to protect consumers from the "burden" of an explicit funding mechanism. In fact, it is the current system that burdens consumers, because it is inefficient and unfair, and because it prevents customers from obtaining the potential benefits of local competition. USTA has performed an analysis, based on a nationwide sample of actual customer bills, to determine the effect of implementing its proposal. The

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16 There is also a transfer of support from one customer to another through the SLC charges themselves. Multiline customers, and even some residence customers in low cost areas, pay SLCs which exceed their interstate loop costs, so that residence and single line business customers in most areas can pay a lower SLC.

USTA proposal would eliminate the interstate PICC and CCL charges, and would replace them with explicit, portable universal service support.[17]

The USTA study examined the bill of each customer in a nationwide sample of residence wireline customers. Implementation of the USTA proposal would have three possible effects on each customer. First, the PICC charges would be eliminated. To reflect this change, for each customer in the sample the USTA study removed any PICC pass-through charge imposed by that customer's interexchange carrier. Second, the CCL charge would be eliminated. To reflect this, the USTA study identified any calls in the customer's billing record which were interstate, and reduced the customer's bill by the national average CCL rate – about 1.1 cents per minute – for each minute of interstate calling. In order to fund this component of the USTA plan, a surcharge of 2.15% on all retail revenue would be required. The USTA study applied this surcharge to the customer's total bill, including both state and interstate services, but excluding non-telecommunications purchases, such as equipment and inside wire maintenance.

The net effect of these changes, as revealed by the USTA study, is that residence wireline customers benefit, on average, from the replacement of implicit support with efficient, explicit support under the USTA plan. The average residence customer's bill declines by about 40 cents per month.[18] Not only do

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17 For a more detailed description of this study, see the attachment filed with USTA's comments in this proceeding.

18 It is possible for residence wireline customers to be made slightly better off as a group, because when an explicit funding mechanism is implemented other groups who have not contributed heretofore, such as wireless and

customers benefit on average, but when customers are segmented according to their income or usage level, customers at every income level, and at every usage level, are made better off. These results reflect the fact that customers in every income group today make significant use of long distance calling, and the fact that customers at every usage level will benefit from the elimination of PICC pass-through charges. The study also examined the group of customers who make no toll calls, and who therefore cannot benefit from the reduction in long distance usage rates. On average, even these customers just about break even.[19] The elimination of the PICC pass-through charges offsets, on average, the surcharge these customers pay to fund the new plan.

The changes in customer bills measured by the USTA study are relatively small. The point is not that the Commission should implement explicit support in order to obtain the benefits estimated in the study. Rather, the point is precisely that the effects are small, and in general positive. This means that the broad policy objectives that the Commission should be seeking from its universal service policy – making universal service support secure, removing price distortions from ILEC rates, and promoting the development of efficient competitive entry – can be obtained by adopting an explicit support program, and all of this can be accomplished without imposing any harm, even in the near

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competitive local exchange carrier ("CLEC") customers, will be brought into the system, as the Act requires.

19 The bills of customers in the zero-usage group declined by an average of five cents per month.

term, on any group of residence subscribers. In the longer term, the most important benefit of an explicit universal service plan might be the one that is most difficult to quantify: the benefit local residence customers will gain because carriers who will finally have access to portable support will actually want to compete for their business. This benefit may take the form of lower prices, new choices, and greater capability than might otherwise have been available to those customers.

B. The States Should Make Intrastate Support Explicit.

Today, the largest source of support for universal service is generated implicitly by intrastate rates for services such as access, toll, vertical services, and some business services. Just as the Second Recommended Decision places responsibility on the Commission to replace the current implicit support generated by interstate access, so also does it place primary responsibility for the replacement of intrastate implicit support on the state commissions.[20] GTE agrees, but notes that the Act requires that the combined effect of state and federal policies on universal service must be sufficient to preserve and advance universal service. The Second Recommended Decision acknowledges this combined responsibility for the overall result.[21]

If the objective required by the Act is to be achieved, then each state must do its part. Action by the state to ensure universal service is not optional, as the

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20 Second Recommended Decision at ¶ 25-26.

21 *Id.* at ¶ 24.

Second Recommended Decision suggests.[22] Section 254(f) of the Act requires that every telecommunications carrier that provides intrastate service shall contribute to the preservation and advancement of universal service on an equitable and nondiscriminatory basis. This provision of the statute is not contingent on any other; while the "manner" in which the contribution shall be made is to be determined by the state, the participation of all carriers on an equitable and nondiscriminatory manner is not at the option of the state, but rather is required. As discussed above in the context of federal support, an implicit mechanism cannot meet this statutory requirement because a system which relies selectively on certain ILEC rates to generate support does not require all carriers to contribute, and the contributions are certainly not equitable and nondiscriminatory.

Thus, in order for the requirements of the Act to be met, each state must act, either to minimize the subsidy through the rebalancing of intrastate rates, or to replace the current implicit support with explicit support, or some combination of these two policies. The Second Recommended Decision is correct when it refers to the state's challenge as a matter of intrastate rate design.[23] However, this should not be taken to mean that any state may continue to maintain universal service by "designing" ILEC rates to generate implicit support. Nor should the Commission underestimate the magnitude of the task faced by the

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22 *Id.* at ¶ 26.

23 *Id.* at ¶ 25.

states. The Second Recommended Decision suggests that present rates "are *sufficient to cover the costs of serving most consumers across the nation."*[24] While it is true that rates in aggregate, for all ILEC services, and all ILEC customers, cover costs, local rates, particularly for residence customers, generally do not cover the cost of local service.

GTE agrees with the Joint Board that the Commission may not require a state to implement a universal service plan.[25] If states fulfill their own responsibilities, the approach outlined by the Joint Board could produce an overall result that is sufficient. However, the Commission does have a plenary responsibility to ensure that the combined effect of state and federal actions meets the requirements of the 1996 Act. In its Report to Congress earlier this year, the Commission recognized this responsibility:

> We also recognize that Congress assigned to the Commission, after consultation with the Joint Board, the ultimate responsibility for establishing policies that ensure that : 1) quality services are available at just, reasonable and affordable rates; 2) all consumers have "access to telecommunications and information services" at rates that are reasonably comparable to the rates charged for similar services in urban areas, and 3) there are "specific, predictable, and sufficient" federal <u>and state</u>

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24 *Id.* at ¶ 15.

25 However, the Commission may condition the receipt of federal universal service funds on the adoption of a state fund that meets some federal guidelines. The Commission does something very similar today with its Lifeline and Linkup programs. It cannot require a state to adopt such a program, but it can configure its own Lifeline program to provide "matching" funds only if the state establishes its own Lifeline mechanism, and only if that state plan satisfies certain guidelines established by the Commission. GTE does not propose such an approach, but merely notes the limits of the Commission's authority.

> mechanisms to preserve and advance universal service. We are committed to implementing section 254 consistent with these objectives.[26]

While the Commission may adopt an approach, as the Second Recommended Decision suggests, that relies on the states to take primary responsibility for addressing implicit support within their own borders, it will still retain this plenary responsibility for the overall result. It must, therefore, ensure that the mechanism it adopts to maintain comparability of rates provides states with sufficient resources to achieve the task assigned to them within the Second Recommended Decision's proposed structure. Further, the Commission must monitor the progress of universal service policies in the states, and be prepared to consider any additional action at the federal level that may be required if states do not take action either to rebalance their local rates or to provide sufficient explicit support for them.

C. The Federal Plan Should Make Sufficient Resources Available To States That Need Them.

The Second Recommended Decision takes a view of universal service responsibility that essentially follows the current jurisdictional division of responsibility for ratemaking. Under this approach, sources of support which are interstate today would remain so, and would remain the responsibility of the Commission, although, for reasons described above, they must be made explicit. Similarly, each state, taking this current flow of federal support as given, would address the problem of arriving at affordable rates within its borders. Each state,

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[26] Report to Congress, FCC 98-67 (released April 10, 1998), at ¶ 19 (emphasis added).

like the Commission, must make any support it chooses to maintain "explicit," although the overall need for support might be reduced by adjustments to local rates.

Within the framework proposed by the Second Recommended Decision, the federal plan would be used to correct any deficiency in the resources available within a given state, which might otherwise make it impossible for that state to maintain an affordable rate comparable to those in other states. The emphasis in this portion of the federal support calculation thus shifts to the maintenance of comparability, rather than achieving a specific affordability target. For this purpose, the Second Recommended Decision focuses on broad measures of the resources each state has available to deal with its universal service funding needs. The level of local rates that would be considered affordable could vary from state to state.[27] The federal plan would assume that the comparability objective has been met if each state has been provided with resources that are roughly comparable. This differs from the plan the Commission adopted in May of 1997, in which the federal plan was designed to assume a specific proportion of the universal service funding need in each small geographic area.

To achieve the goal of comparability, the Second Recommended Decision proposes a two-pronged approach. First, a measure of average cost per line would be compared across study areas. To qualify for support, a study area

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27 The Commission had already deferred the initial determination of affordability to state commissions in its *Universal Service Order*.

would have costs more than a specified percentage above the national average.[28] This first step is very similar to the current federal high cost fund, except that forward-looking cost estimates are used in place of embedded costs. Second, the Second Recommended Decision suggests that some additional test should be applied to measure the state's capacity to meet its own funding needs. Several possible approaches are mentioned; one would involve calculating the percentage surcharge a state would need to fund its own universal service program, and providing federal funding as needed to cap this surcharge.[29]

The Second Recommended Decision's approach raises several concerns.

First, the proposal as outlined is very general, and it is not possible to evaluate with any accuracy how the proposed plan might be implemented. As the Second Recommended Decision itself notes, the fact that the Commission's cost model is not yet available makes it impossible to estimate the results of any calculation that depends on the model.[30] Further, several alternative calculations are suggested in the Second Recommended Decision. GTE has repeatedly urged the Commission to finalize its cost model – including its inputs – before it attempts to define the calculation in which the cost estimates will be used. The

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28 The Second Recommended Decision (at ¶ 43) suggests that this percentage could be between 115 percent and 150 percent of nationwide average costs.

29 The Second Recommended Decision (at ¶ 45) suggests that this cap on the state surcharge might be between 3 and 6 percent.

30 *Id.* at ¶ 29.

Commission should provide an opportunity for parties to comment on the support calculation <u>after</u> the model and its inputs have been made publicly available.

Second, if, as the Second Recommended Decision contemplates, the amount of support provided to the states is limited, with an emphasis on comparability, then this component of the federal fund will be a relatively small proportion of the overall funding need. Within this framework, the larger component of the federal universal service mechanism will be the fund needed to replace implicit support in interstate access.

Third, while the component of the federal fund that ensures comparability across states would be determined on a study area level, this does not imply that the need for funding in general should be determined at that level, or that support should be distributed on a study area average basis. Indeed, the Commission has repeatedly emphasized the need to target support to smaller geographic areas. All of the available cost models indicate that the cost of basic local service varies dramatically within a study area. Commissioners Johnson and Baker, in their joint separate statement, remind us that competition is also likely to develop at different rates in different areas.[31]

The Second Recommended Decision envisions that support from this component of the federal fund would be provided directly to carriers by the federal fund administrator, rather than through state commissions.[32] Yet there is

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31 Joint Statement from Julia L. Johnson and Commissioner David Baker, at 1.

32 Second Recommended Decision at ¶ 61.

no discussion in the Second Recommended Decision of how support would be distributed to carriers within each study area, other than that it would be portable. GTE submits that it is not reasonable to provide the same level of support per line in an urban, low cost portion of a study area as in a rural, high cost portion of the same study area. The Second Recommended Decision acknowledges this in its discussion of the use of support in paragraph 58: "(w)e further recognize that, even if costs are calculated at the study area level, high cost support should be targeted to consumers living in the highest cost areas of the study area." The Second Recommended Decision then suggests that "a state might require that federal support be targeted to those consumers living in the highest cost areas within a study area." However, the Second Recommended Decision makes no proposal as to how this might be done. A state requirement as to where the funds should be used would appear to be inconsistent with distribution of the funds by the federal fund administrator, which the Joint Board also recommends. Simply directing a given carrier to "use" some portion of its funding in a given small geographic area will not ensure that competitively neutral, portable funding will be available in each such area in an amount that reflects that area's relative cost.

In order to "provide efficient incentives for competitive entry"[33] the Commission should consider a mechanism which would allow the average per-line amount determined for each study area to be deaveraged on the basis of

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33 *Id.* at ¶ 58.

smaller geographic areas. The relative cost levels estimated by the cost model for small geographic areas could be used for this purpose.[34]

Fourth, the Second Recommended Decision appears to assume that the funding that states will need in order to maintain comparable and affordable rates will not substantially exceed the amount provided by the current federal high cost mechanisms.[35] It is difficult to see how this conclusion could have been reached in the absence of any cost estimates, or any definition of the calculation to be used. GTE urges the Commission not to approach the determination of the cost estimates, or the parameters of the support calculation, in a results-oriented manner with a view to achieving a predetermined amount of support.

Fifth, determining support on the basis of average study area costs would essentially shift the mean of the distribution of cost in each high-cost state downward, toward the national mean. However, the universal service funding challenge faced by each state will depend on the distribution of cost within the state, and not simply on the mean. A state with a high variance in its cost distribution will have to raise and distribute more universal service finding than a state with the same mean, but a smaller variance. Care must therefore be taken to define the second step in the two-step process proposed in the Second

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34 A similar concern arises for the explicit support used to replace the implicit support generated today by interstate access. The USTA proposal for this component of federal funding would also determine the amount of support available on a study area basis, but would then deaverage the per-line portable support amount, using the cost model estimates of relative cost by small geographic area.

35 *Id.* at ¶ 49.

Recommended Decision. It is not clear from the example given in the Second Recommended Decision (at & 45) what measure of the state's universal service "need" would be compared to its intrastate revenues. The amount by which average cost in the study area exceeds the national cost benchmark – the measure used in the first step – is not a measure of the state's "high cost responsibility," as the Second Recommended Decision suggests.

Sixth, GTE supports the recommendation that the benchmark for the first step in the support determination should be based on average cost, and not on average revenue. The use of an assumed revenue level in the Commission's previous universal service decision has led several states to assume, mistakenly, the same level of revenue, even when the local rates approved by those states did not in fact generate the assumed revenues. A federal cost benchmark is not open to such a misinterpretation.

III. THE COMMISSION SHOULD ADOPT THE "HOLD HARMLESS" PROVISION RECOMMENDED BY THE JOINT BOARD.

The Second Recommended Decision notes that the Commission has committed to Congress that no state should receive less support under the new plan than it currently receives. Accordingly, the Joint Board recommends that no non-rural carrier, including Puerto Rico Telephone Company ("PRTC") should receive less federal high cost assistance than the amount it currently receives from explicit support mechanisms.[36] GTE supports this recommendation. The

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36 Second Recommended Decision at ¶ 53. The Joint Board notes, however (at n. 56), that an ILEC might experience a change in support as it loses customers to competition, because the new support would be portable.

new federal universal service plan should not leave states worse off than they are under the current arrangements. The current amounts of federal assistance have already been incorporated into state rates, which now depend on the maintenance of those support levels.

The meaning of the "hold harmless" provision is open to interpretation, in part because the results of the current support calculation are a moving target, changing over time with changes in costs and line counts in each study area. When the Commission decided to defer consideration of any major changes in support for rural areas for three years, it froze the then-current support amount on a per-line basis, and made that amount portable. GTE suggests that a similar frozen per-line amount should serve as a floor for the average per-line support provided in non-rural areas.

A significant amount of the federal high-cost support provided under current "explicit support mechanisms" comes through the Long Term Support ("LTS") program. Among the nonrural companies, PRTC is the major recipient of LTS because of its continued participation in the NECA common line pool. Under current rules, PRTC will have to leave the NECA pool when it becomes part of GTE. In light of the specific inclusion of PRTC in the "hold harmelss" recommendation of the Joint Board, the Commission should make it clear that the current support level for PRTC to which the "hold harmless" provision should apply includes PRTC's LTS funding, as well as its current funding from the federal high cost fund.

IV. THE USE OF COST MODEL ESTIMATES

The Joint Board expresses a number of reservations concerning the accuracy, openness, and availability of the Commission's forward-looking cost model.[37] In spite of these concerns, the Second Recommended Decision endorses the use of forward-looking cost estimates for the determination of universal service support.[38] In partial justification of this proposal, the Second Recommended Decision notes that the proposals submitted by most parties involved the use of forward-looking cost estimates for some portion of the support calculation.[39]

GTE recognizes that forward-looking cost estimates can be useful as a source of information about the relative levels of cost -- across geographic areas, and across services. GTE's own proposals, and that of USTA, which GTE supports, make use of forward-looking cost estimates in this way. Several of the Joint Board members, in their remarks in the open meeting of November 23, 1998, emphasized that the Second Recommended Decision proposed the use of forward-looking estimates only to distribute support, not to determine the overall level of support. Similarly, the Second Recommended Decision emphasizes that "a cost model's estimation of the forward-looking cost to provide supported

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37 *Id*. at ¶ 29. Several of the Commissioners expressed similar concerns in their remarks in the open meeting on November 23, or in their separate statements.

38 *Id*. at ¶ 27.

39 *Id*. at ¶ 29.

services does not alone determine the amount of support that will be needed in the aggregate or that any given carriers will receive."[40]

There is good reason to avoid basing support calculations solely on the cost model estimates, without reference to any other source of information. None of the available cost models previously considered by the Commission (HAI, BCPM, HCPM), nor the Commission's new platform model, estimates a cost that corresponds to the economic concept of long-run forward-looking cost. None of the models is an accurate estimator of the aggregate level of a LEC's cost, as opposed to the relative cost levels of different outputs. Even though the models appear complex, they actually operate on relatively little information about each local area; much of each model's result is driven by the assumptions and heuristics built into it. Finally, securing accurate input data has proven both difficult and controversial. Comparison of the estimates produced by the different models shows dramatic differences, which makes it difficult to conclude that any of them are accurate.[41]

Because of the need to target support, GTE agrees with the Joint Board that forward-looking cost models have a role to play. However, it is also important that the Commission should establish aggregate targets for universal

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40 *Id.* at n. 41.

41 In its comments (at 15-18) in CC Docket No. 96-262 dated October 26, 1998, GTE provided a more detailed discussion of the application of the cost model estimates to the determination of rates and universal service support in its comments in response to the Commission's request to update the record on access reform.

service support based on information from other sources, so as to ensure that errors in the model do not lead to large errors in the aggregate support amount.

While Joint Board members have emphasized that the role of the model in the proposed framework is only to determine relative support amounts, it would appear that, for the portion of the fund devoted to ensuring comparability among states, the model will in fact determine the aggregate amount of that component of the funding. The larger the variance across the study area average costs estimated by the model, the larger the amount of cost that will lie above the federal cost benchmark, and the larger the fund will be.

For the component of the fund that replaces implicit support in interstate access rates, USTA has proposed an approach that determines the amount of support at the study area level first, and then uses the cost model estimates to target the per-line support amounts more accurately to reflect cost differences across smaller geographic areas within the study area. The USTA plan provides an external target for the aggregate support amount, which is not sensitive to errors in the cost estimates. As GTE has previously explained in its comments, the model estimates do not provide a sound basis for establishing a different cost recovery level for the ILEC industry. The Commission should continue to rely on the price cap mechanism to determine the overall cost level the ILECs will be permitted to recover through interstate rates.

V. THE COMMISSION SHOULD DEVELOP A MARKET-BASED ALTERNATIVE FOR DETERMINING SUPPORT.

The Second Recommended Decision claims that "(n)o party has suggested that there is a method preferable to a model to determine support..." That is not true. GTE has proposed that a system of competitive bidding would be more accurate and more competitively neutral than determining support on the basis of cost, however estimated. Such a system would provide better incentives for incumbents, for entrants and for the Commission. It would automatically adjust to changes over time in costs, input prices, technology, and in the definition of the supported services.

In its auction proposal, GTE has recognized the need to establish an initial level of support on the basis of cost. However, GTE urges the Commission to move ahead to develop an auction mechanism that could be implemented after the new support takes effect in July, 1999. This competitive bidding system would provide a mechanism for correcting errors in the initial support estimates, as well as for updating the support amounts as needed over time.

VI. MECHANISM FOR DISTRIBUTING SUPPORT

The Joint Board recommends that federal universal service support should be made portable to eligible telecommunications carriers ("Eltels").[42] GTE agrees that federal support should be portable. However, the Second Recommended Decision also finds that the Commission may condition the receipt of federal high cost support to ensure that the support is used in a

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42 Second Recommended Decision at ¶ 56.

manner consistent with Section 254.[43] GTE believes that such a condition is extremely important; without it, it will be relatively easy for carriers to receive support without taking on any meaningful universal service obligation, or contributing to the policy goals Section 254 was meant to achieve.

GTE does not believe that it will, in general, be useful for the Commission to attempt to trace the use a carrier makes of any particular dollar of support. However, there is a simple condition that would be relatively simple to establish and to monitor, and which would be useful in ensuring that carriers do in fact use support in a manner consistent with Section 254.

In the absence of any condition on the receipt of support, a carrier will be able to serve selectively, targeting only the more desirable customers in a given area, while avoiding the majority of customers seeking affordable basic service. The carrier can offer service only in packages designed to appeal to the customers it wishes to serve. For example, if the carrier wishes to target customers with high toll usage, it could offer a package of service that includes a block of toll calling, in addition to the supported basic service function. The price of the package would be attractive to the heavy toll user, but not affordable for the majority of customers. If such a service were offered to all the customers in a given service area, it might meet the letter of Section 214(e), which establishes

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43 *Id.* at ¶ 57.

the procedure for designating eligible telecommunications carriers.[44] An Eltel is "eligible" to receive support "in accordance with" Section 254. GTE submits that the use of packaging to "cream-skim" only the most desirable customers – those who would most likely be served even in the absence of support – is not "in accordance with" Section 254.

GTE proposes a simple condition which could be established by the Commission, and which would prevent federal support from being used in this selective fashion. The Commission has already deferred the determination of the rate level for local service that is "affordable" to the state commissions. The Commission could require, as a condition for the receipt of federal high cost support, that an Eltel must offer at least one service package that:

- Meets the Commission's definition of the supported service, and
- Is offered at a rate that does not exceed the "affordable" price established by the state commission. The package could include functions not in the definition, as long as it is offered at the "affordable" price. Similarly, the carrier could offer other packages at higher prices, or optional features which could be added to the basic package.[45]

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44 The Eltel is required to offer a service throughout the area that meets the definition of the supported service, and to advertise the availability of and the charges for the service.

45 GTE recommends that if an Eltel satisfies this requirement, then any package the carrier offers should be supported, as long as it meets the definition; this would be done to ensure that the support did not bias customers' choices between new and old services, or between larger and smaller packages.

GTE believes that this requirement would effectively ensure that a carrier used the federal support it receives in a manner consistent with Section 254. At the same time, it would be relatively simple to implement, and it is designed to avoid any unnecessary restriction on a carrier's ability to package and market service options to its customers. The Second Recommended Decision finds that conditioning support to ensure that funds are used for the advancement of universal service does not place any restrictions on the determination of a carrier's status as an Eltel, and is thus not inconsistent with Section 214(e).[46]

VII. CONTRIBUTIONS SHOULD BE BASED ON STATE AND INTERSTATE RETAIL REVENUES, AND CARRIERS SHOULD BE ABLE TO RECOVER THOSE CONTRIBUTIONS FROM THEIR CUSTOMERS.

The Commission has already found that it has the authority to assess contributions on a base of a telecommunications carrier's total retail revenue, both state and interstate.[47] The Commission already uses such a base for determining contributions to the school and library fund. The Joint Board recognizes this authority, finds that there are significant advantages to a base of total retail revenues, and suggests that the Commission should consider using that assessment methodology for federal high cost support.[48] GTE agrees, and strongly urges the Commission to adopt a funding base of total retail revenue, both state and interstate. GTE also agrees with the Second Recommended

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46 Second Recommended Decision at ¶ 60.

47 *Universal Service Order* at ¶ 807 and Report to Congress at ¶ 202.

48 Second Recommended Decision at ¶ 63.

Decision that states should also be free to use the same base for their state universal service mechanisms.

The Commission now has concurrence from the Joint Board to proceed with the funding method that has always made the most sense. As the Second Recommended Decision notes, a base of total retail revenue will provide the largest possible revenue base, and will thus make possible the smallest and least distorting percentage rate of contribution. This combined funding base will also obviate the need to report state and interstate revenues separately, will eliminate the incentive to misreport revenues, and will avoid competitive distortions caused by such misreporting.[49] It will also avoid both the administrative burden and the possible competitive effects of attempting to disentangle the jurisdictional nature of service packages.

The Second Recommended Decision also recommends that carriers should be allowed to recover their contributions from their customers, and that they may use a separate line item on the bill for that purpose.[50] The Joint Board recommends that the Commission should provide reasonable guidance to carriers as to how these charges are assessed, and how they are characterized on customers' bills.

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49 The Commission has recently grappled with the difficulty of determining what proportion of a wireless carrier's revenue is interstate. Memorandum Opinion and Order and Further Notice of Proposed Rulemaking, FCC 98-278 (released October 26, 1998).

50 Second Recommended Decision at ¶ 69.

GTE urges the Commission to clarify that any carrier, including an ILEC, may recover its contribution from its customers through a separate line item on the customer's bill. This is a particularly important issue of competitive neutrality for ILECs, such as GTE, that do not have the freedom to adjust their rates that other carriers have. For the current school and library fund, the Commission has required ILECs to contribute on the basis of their total retail revenue, but has not allowed ILECs to recover their contributions from the customers whose purchases trigger them. The result is that ILEC interstate access charges are artificially inflated, since they are the only rates through which the Commission has allowed ILECs to recover their contributions. The Second Recommended Decision proposes that the Commission should limit the amount of any such line item to be no greater than the carrier's assessment rate on the customer's retail revenue. GTE believes that such a constraint is reasonable.

VIII. CONCLUSION

Further definition and development needs to be given to the proposals set forth by the Joint Board in its Second Recommended Decision. The Commission must ensure that its federal plan, in combination with the support mechanisms devised by the states, will meet the requirements of the 1996 Act and provide the carriers with sufficient and predictable support. GTE endorses the USTA proposal that would replace the interstate PICC and CCL with an explicit and portable universal service mechanism and would benefit all customers.

GTE continues to insist that a competitive bidding process is the more accurate and more competitively neutral mechanism by which to determine support. The Commission should proceed to develop an auction mechanism that could be implemented after the new support mechanism in July, 1999. This competitive bidding system would provide a mechanism for correcting errors in the initial support estimates, as well as for updating the support amounts as needed over time.

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Respectfully submitted,

GTE Service Corporation and its
designated affiliated companies

John F. Raposa
GTE Service Corporation
600 Hidden Ridge, HQE03J27
P.O. Box 152092
Irving, TX 75015-2092
(972) 718-6969

By ______________________
Gail L. Polivy
GTE Service Corporation
1850 M Street, N.W., Suite 1200
Washington, DC 20036
(202) 463-5214

Their Attorneys

CERTIFICATE OF SERVICE

I, Faye Payne, hereby certify that copies of the foregoing "Comments of GTE" have been mailed by first class United States mail, postage prepaid, on December 23, 1998 to all parties of record and the joint board.

Faye Payne

Faye Payne